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October 4, 2004

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OCT - 4 2004

Federal Communications Commission
Office of Secretary

BY HAND

Marlene M. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: WC Docket No. 03-171 and CC Docket Nos. 96-98, 99-68, and 01-92

Dear Ms. Dortch:

With the filing of its forbearance petition, Core Communications, Inc. ("Core") demonstrated that the Commission should forbear from any application of the interim regime established by the *ISP Remand Order*.[1] Section 10(c) of the Communications Act, 47 U.S.C. § 160(c), **requires** the Commission to forbear from application of its rules and orders in cases where: (a) enforcement of such rules and orders is unnecessary to prevent unjust and unreasonable discrimination against carriers; (b) enforcement of such rules and orders is unnecessary to prevent unjust and unreasonable discrimination against consumers; and (c) forbearance is consistent with the public interest. Under this standard, the remanded *ISP Remand Order* regime simply cannot survive as its enforcement results in affirmative discrimination against carriers, affirmative discrimination against consumers, and in so doing, the *ISP Remand Order* contradicts the public interest.

First, the cost of terminating ISP-bound traffic and local voice traffic is the same. In the *ISP Remand Order*, the Commission found as a factual matter that there is "no reason to impose different rates for ISP-bound and voice traffic" because the record "fail[ed] to establish any inherent differences between the costs on any one network of delivering a voice call to a local end-user and a data call to an ISP."[2] The Commission further concluded that "a LEC generally will incur the same costs when delivering a call to a local end-user as it does delivering a call to an ISP."[3] This result was not surprising, as the Commission as early as 1996 recognized

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1 Order on Remand and Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, 19 FCC Rcd 9151 (2001) ("*ISP Remand Order*") *remanded, WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir 2002), *cert. denied*, 123 S. Ct. 1927 (2003).

2 *ISP Remand Order* at ¶ 90.

3 *Id.*

"that transport and termination of traffic ... involves the same network functions."[4] Accordingly, the Commission concluded that "the rates that local carriers impose for the transport and termination ... should converge."[5] Although the Commission promulgated rules setting forth symmetrical rates for ISP and voice traffic in 1996, the Commission incorrectly abandoned that principle in the *ISP Remand Order* and instead acted affirmatively to discriminate against carriers and consumers by setting forth a rate cap, growth cap, and new market bar that radically reduced the ability of LECs serving ISP end users from recovering their network costs.

Second, there can be no doubt that on-going enforcement of the *ISP Remand Order* results in discrimination against LECs serving ISPs and ISPs as consumers. As the Intercarrier Compensation Forum recently noted, the existing intercarrier compensation regime harms consumers and the economy.[6] Furthermore, the ICF noted:

> The existing intercarrier compensation regime "create[s] artificial regulatory advantages and disadvantages among carriers, leading to arbitrage, distorting consumer choices in the market and creating uneconomic substitutions. In addition, compensation disputes divert resources that otherwise could be used to deliver newer, cheaper, and better services in the market. Uncertainty limits carrier ability to formulate business plans and impedes access to capital markets.[7]

The extreme harm to consumers, carriers, and the economy resulting from the existing intercarrier compensation disparities is most acute with regard to ISP-bound traffic. The ICF identified 10 – yes 10 – different intercarrier compensation categories for transport and termination functionality that the Commission repeatedly has found to have the exact same cost basis.

In spite of performing the exact same transport and termination functionality, LECs terminating ISP-bound traffic receive by far the absolute lowest amount of intercarrier compensation.[8] Under the *ISP Remand Order*, carriers terminating ISP-bound traffic at best receive $0.0007 per minute, subject to a ceiling that precludes any market growth. In so-called "new markets," competitive LECs are precluded from obtaining any compensation at all.

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[4] First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98, 95-185, 11 FCC Rcd 15499, ¶ 1033 and n. 2460 ("*Local Competition Order*") (subsequent history omitted).

[5] *Id.*

[6] Letter from Intercarrier Compensation Forum to Chairman Powell et al., WC Docket No. 01-92 at 2 (Aug. 13, 2004) (attached hereto as Tab A).

[7] *Id.*

[8] Intercarrier Compensation Forum, Intercarrier Compensation and Universal Service Reform Plan, WC Docket No. 01-92 (Aug. 13, 2004) (excerpts attached hereto as Tab B) .

This result – an FCC mandate that competitive LECs terminating ISP-bound traffic receive intercarrier compensation rates that are materially lower (if not zero) than what the incumbent LECs receive for the identical functionality – gives the incumbent LECs license to engage in pernicious arbitrage against competitors. As noted in a recent ex parte letter filed by KMC Telecom, XO Communications, and Xspedius Communications:

> [I]ncumbent LEC avoidance of cost-based reciprocal compensation obligations is arbitrage. If the penny-a-minute rates that prevailed in the late 1990s were too high, it is because the incumbents themselves set them or had too strong a hand in setting them. Today's state commission-approved and section 252(d)(2) compliant rates are much lower. Certain states have even adopted new rate structures that further drive down the rates associated with calls, such as ISP-bound calls, that typically have long holding times. And, there is seldom heard a claim from incumbent LECs that these TELRIC-based rates for switching functionality are *too low*, as they are seemingly pre-programmed to complain about other TELRIC-based rates. On the other-hand, the prevailing FCC-set rate of $0.0007 is generally much lower than the TELRIC-based reciprocal compensation rates which the ILECs had every incentive to drive down. The FCC-set rate is, by definition, below cost. Whether above or below cost, somebody gains and somebody loses. In the case of ISP-bound traffic, the FCC-set below cost rate results in the FCC picking the incumbent LECs as the winner of an underserved subsidy from their much smaller competitors. With the uniform application of cost-based rates – carriers simply pay for what they get – and there are no winners and losers arbitrarily chosen.[9]

The *ISP Remand Order's* intercarrier compensation regime (even where any positive rate exists at all) is directly antithetical to the Commission's previous, correct finding that "as long as the cost of terminating traffic is positive, bill-and-keep [and below-cost] arrangements are not economically efficient because they distort carriers' incentives, encouraging them to overuse competing carriers' termination facilities by seeking customers that primarily originate traffic."[10] The Commission must end the distortions created by the *ISP Remand Order*, and grant of Core's petition is the appropriate means of so doing.

Third, the decline in the dial-up ISP market, which is expected to continue at an accelerated pace, eliminates any justification for on-going enforcement of the *ISP Remand Order*. In the *ISP Remand Order*, the Commission justified its implementation of the rate cap, growth cap, and new market bar in substantial part on "the tremendous growth in dial-up Internet access since the passage of the 1996 Act."[11] To the extent that this ever could have been a reasonable basis for forcing competitive LECs to subsidize incumbent LEC calling, that rationale

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9 Letter from John J. Heitmann, counsel to KMC Telecom, XO Communications, and Xspedius Communications, to Marlene M. Dortch, FCC, CC Docket Nos. 96-98 and 99-68 at n. 6 (Oct. 1, 2004) (emphasis original) (attached hereto as Tab C) .

10 *Local Competition First Report and Order* at ¶ 1033.

11 *ISP Remand Order* at ¶ 69.

has evaporated with the decline of dial-up Internet access, which has resulted in large part to broadband deployment.

The record in CC Docket Nos. 96-98, 99-68, and 01-04 demonstrates unequivocally that dial-up Internet access is on the decline. In its September 4, 2004 ex parte, Sprint put evidence on the record demonstrating a 1.36% decline in dial-up minutes over the six-month period from September 30, 2003 through December 31, 2003.[12] Similarly, Level 3 has included evidence in the record of those proceedings that show that dial-up penetration has been declining steadily since 2002, and is expected to decline precipitously in the immediate future.[13] Even Verizon has acknowledged that "broadband Internet access recently surpassed dial-up for the first time as the primary mode of Internet access in this country."[14] In a declining industry sector, items such as growth caps and new market bars are unjustified and unjustifiable.

For the reasons set forth above as well as for the reasons set forth in Core's other filings in these proceedings, the Commission without question should grant Core's petition and forbear from the *ISP Remand Order*. In accordance with the Commission's rules, an original and two copies of this letter is enclosed for filing in each of the dockets referenced above. Please stamp and return to the courier the duplicate copy provided.

Sincerely,

Michael B. Hazzard
Counsel for Core Communication, Inc.

cc: Scott Bergmann
Matt Brill
Jeff Dygert
Dan Gonzalez
Jane Jackson
Chris Killion
Chris Libertelli
Steve Morris
Tamara Preiss
Jessica Rosenworcel
Victoria Schlesinger
Austin Schlick
Rob Tanner

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12 Letter from Norina Moy, counsel to Sprint, to Marlene H. Dortch, FCC (Sept. 22, 2004) (attached hereto as Tab D).

13 Letter from John Nakahata, counsel to Level 3 Communications, to Marlene H. Dortch, FCC, CC Docket No. 96-98, CC Docket No. 99-68, WC Docket No. 03-266, WC Docket No. 04-36 (June 25, 2004) (attached hereto as Tab E).

14 Brief of Verizon Telephone Companies et al. in Support of Petition, Supreme Court Nos. 04-277 & 04-281 (excerpts attached hereto as Tab F).

TAB A

Michael K. Powell, Chairman
Kathleen Q. Abernathy, Commissioner
Michael J. Copps, Commissioner
Kevin J. Martin, Commissioner
Jonathan S. Adelstein, Commissioner
Federal Communications Commission
445 12th Street SW
Washington, DC 20554

Dear Chairman Powell and Commissioners Abernathy, Copps, Martin and Adelstein:

Each undersigned company is a member of the Intercarrier Compensation Forum ("ICF") and agrees with and fully supports the ICF's Intercarrier Compensation and Universal Service Reform Plan. We strongly urge the FCC to adopt the Plan as proposed so that it can be implemented by July 1, 2005.

Very truly yours,

James W. Cicconi

AT&T Corp.
Name: James W. Cicconi
Title: General Counsel and Executive Vice President Law & Government Affairs

General Communication, Inc.
Name: Dana L. Tindall
Title: Sr. Vice President, Legal & Regulatory Affairs

Iowa Telecom
Name: D. M. Anderson
Title: Vice President- External Affairs

Level 3 Communications, LLC
Name: Thomas C. Stortz
Title: Executive Vice President and Chief Legal Officer

Anastasia D. Kelly

MCI, Inc.
Name: Anastasia D. Kelly
Title: Executive Vice President General Counsel

SBC Communications Inc.
Name: James D. Ellis
Title: Senior Executive VP & General Counsel

Tom Gerke

Sprint Corporation
Name: Thomas A. Gerke
Title: Executive Vice President – General Counsel and External Affairs

Valor Telecommunications
Name: William M. Ojile, Jr.
Title: Sr. Vice President, Chief Legal Officer & Secretary

Paul Kouroupas

Global Crossing North America Inc.
Name: Paul Kouroupas
Title: Vice President, Regulatory Affairs

Intercarrier Compensation Forum

Executive Summary of
Intercarrier Compensation and Universal Service Reform Plan
August 13, 2004

This document summarizes a comprehensive plan for intercarrier compensation and universal service reform developed by the Intercarrier Compensation Forum ("ICF"). The ICF members are united in their belief that the current myriad of disparate intercarrier compensation regimes is not sustainable in its present form and cannot be fixed. It harms consumers and creates artificial regulatory advantages for certain carriers and technologies at the expense of others. In doing so, it creates opportunities for regulatory arbitrage that threaten universal service in addition to the fundamental integrity and reliability of the nation's telecommunications carriers and networks.

The ICF's Plan represents a consensus proposal for reforming intercarrier compensation and universal service issues in a manner that will facilitate efficient competition, promote the deployment of new technologies, preserve and enhance universal service, and advance consumer interests.

I. Background on the Intercarrier Compensation Forum Plan

The ICF is a diverse group of telecommunications industry participants representing incumbent local exchange carriers, competitive local exchange carriers, interexchange carriers, next-generation network providers, rural telephone companies, and wireless service providers. Its current membership consists of: AT&T Corporation, General Communication, Inc., Global Crossing North America Inc., Iowa Telecom, Level 3 Communications, LLC, MCI, Inc., SBC Telecommunications Inc., Sprint Corporation, and Valor Telecommunications, Inc.

Members of the ICF have worked diligently for over one year to craft a balanced, detailed, operational Plan to reform today's broken network interconnection, intercarrier compensation, and universal service regulations. At least 25 companies have participated at various times as members of the ICF, and their contributions continue to shape the Plan. In addition, the ICF has received and incorporated input from numerous rural carrier trade associations. As a result, the ICF Plan is the only one existing today that embodies a consensus solution based on input from a broad range of normally divergent interests, and it is the only one to address a full range of network interconnection, intercarrier compensation, and universal service in a comprehensive manner.

II. Today's Rules Are Broken Beyond Repair and Must Be Replaced

Today's myriad network interconnection and intercarrier compensation schemes no longer reflect the world in which we live. Technological advances have given residential and business consumers telecommunications options that did not previously exist, including alternatives from local telecommunications providers, wireless services, and packet technology. Regulators have developed today's diverse assortment of intercarrier compensation regimes in a piecemeal fashion as these technologies evolved, causing carriers artificially to distinguish calls

– and the payments for these calls – based purely on such factors as the end points of the communication (*e.g.*, local or long-distance, interstate or intrastate), the carriers involved (*e.g.*, ILEC, CLEC, CMRS, or IXC), and the technologies involved (*e.g.*, wireline circuit-switched voice, wireless, ISP-bound, or packet-switched services).

These disparities harm consumers. The current regime forces carriers to make arbitrary distinctions between "local" and "long-distance" services, limiting local calling scope and making it more difficult for consumers to receive the service bundles they want. Jurisdictional disparities in intercarrier compensation often make it more expensive to call across the state than across the country or around the world. Rural and low-income consumers suffer even greater harm. High access charges limit long distance choice for rural consumers, reduce incentives for rural carriers to market DSL services, and inflate toll rates. Some low-income consumers may lose service when they incur large toll bills they cannot afford to pay.

Today's outmoded rules also harm the economy. They create artificial regulatory advantages and disadvantages among carriers, leading to arbitrage, distorting consumer choices in the market and creating uneconomic substitution. In addition, compensation disputes divert resources that otherwise could be used to deliver newer, cheaper, and better services in the market. Uncertainty limits carrier ability to formulate business plans and impedes access to capital markets.

Finally, today's broken system threatens universal service. Because implicit support has not yet been fully removed from existing intercarrier compensation schemes, universal service remains vulnerable as competition increases. In addition, interstate telecommunications revenues, on which universal service contributions are based, are becoming more difficult to identify and are undoubtedly shrinking. As a result, some providers are able to avoid some or all of their contribution obligations, as consumers increasingly bypass interstate long distance offerings in favor of wireless services, bundled service, and information services.

III. The ICF Plan

The ICF has developed a single consensus Plan for reforming today's outmoded network interconnection, intercarrier compensation and universal service rules, in order to advance consumer interests, facilitate efficient competition, promote the deployment of new technologies, and preserve and enhance universal service. To accomplish these goals, the Plan begins to restructure rates on July 1, 2005 to bring immediate relief from today's broken system. Within three years, it unifies the disparate network interconnection and intercarrier compensation regimes governing interstate switched access, intrastate switched access, reciprocal compensation, compensation for ISP-bound traffic, inter- and intra-MTA CMRS traffic, paging traffic, and traffic with one end originating or terminating on IP networks. The Plan has three primary sections: (1) Network Interconnection; (2) Rate Restructuring; and (3) Universal Service.

A. Network Interconnection

Developing uniform network interconnection rules is an essential prerequisite for restructuring rates to unify intercarrier compensation. Thus, the ICF Plan establishes clear and explicit technical and financial rules to govern the efficient interconnection of diverse carrier networks. These rules would take effect on July 1, 2007 and provide a framework for voluntary carrier negotiations and establish default responsibilities in the absence of any carrier agreement to the contrary. The ICF Plan classifies carrier networks into three categories – hierarchical, non-hierarchical, and rural – and specifies rules for interconnection with each. These rules are based on the concept of network "Edges," which are specified points at which these networks interconnect for the delivery of terminating traffic. Network Edges must be able to accept all types of public switched telephone network traffic, and are subject to numerical, functional, and locational requirements specified in the Plan.

The network interconnection rules in the ICF Plan are explicitly designed to protect universal service in rural America by establishing modified default rules to apply to networks operated by a Covered Rural Telephone Company ("CRTC"), as defined in the Plan. A CRTC is not required to deliver traffic to an interconnecting carrier at a point outside of the contiguous portion of its study area where the traffic originates, except to reach another CRTC within the same LATA. In addition, the Plan continues to provide a very important additional transport revenue stream for CRTCs.

B. Rate Restructuring

The Plan replaces revenue from today's intercarrier charges with a fundamentally new system comprised of end user charges, new federal universal service support, revenue from interconnection transport and transiting charges, revenue from a transitional uniform termination charge, and terminating transport revenues for CRTCs. Starting July 1, 2005, all intercarrier compensation transitions in four annual steps over three years to a uniform system with a single termination rate of \$0.000175 per minute for all traffic. Beginning July 1, 2007, with no sunset, carriers also may receive intercarrier payments for tandem transiting services, interconnection transport, and, for CRTCs, terminating transport revenues at prescribed rates for inbound traffic. Commencing July 1, 2010, the \$0.000175 per minute termination rate is reduced to zero in two equal annual steps.

Revenue eliminated from intercarrier compensation as a result of this transition is replaced by a combination of end user charges and new federal universal service support. For large carriers, the maximum monthly residential and single-line business subscriber line charge ("SLC") cap increases by \$0.75 in each of the first two years of the Plan. In each of the next two years, it increases by \$1.00, on July 1, 2007 and by \$1.00 on July 1, 2008. The non-primary residential and multiline business SLC caps increase only to the extent that they otherwise would be below the residential cap. A carrier's average SLC also may rise no more than \$0.75, \$0.75, \$1.00, and \$1.00 at each of these steps, respectively, although individual SLCs that are significantly below the \$6.50 cap before the start of the transition may increase by a slightly greater amount. As of July 1, 2008, all monthly SLC caps for non-CRTCs are unified, and the SLC cap is indexed for inflation starting on July 1, 2009.

The Plan protects rural America by creating a more measured transition for CRTC customers. A CRTC's maximum monthly residential and single line business SLC cap increase by \$0.50 per year, from \$6.50 today to \$9.00 effective July 1, 2009. On July 1, 2008, a CRTC's multiline business SLC cap increases to \$10.00. A CRTC has the option to increase the residential monthly SLC cap by two additional $0.50 annual increments beginning July 1, 2010, but no CRTC SLCs are indexed for inflation.

The Plan also achieves greater regulatory parity among carrier types by creating specified pricing flexibility for price cap ILECs. Subject to consumer protection safeguards, the Plan provides increased price cap carrier pricing flexibility, effective July 1, 2005, and a further measure of pricing flexibility for these carriers, effective July 1, 2008.

C. Universal Service

The Plan creates two new universal service mechanisms to provide explicit support for intercarrier compensation amounts otherwise not recoverable under the Plan's rate restructuring rules, one applicable to areas served by BOCs and other non-CRTC ILECs and one applicable to areas served by CRTCs. The primary differences between the two are the extent of availability (during a transitional period) of this new support to competitive eligible telecommunications carriers (CETCs) and the disaggregation options available to recipients.

The first, the "Intercarrier Compensation Recovery Mechanism," or "ICRM," provides support to BOCs and non-CRTC ILECs. It is available, on a per-eligible-line basis, to all CETCs competing with these carriers. By default, ICRM is available as a uniform, per-line amount to all eligible lines (*i.e.*, no disaggregation). ILECs have two alternatives to this default. A recipient ILEC may establish a Zone Disaggregation Plan. In the alternative, an ILEC may establish a Residential Targeting Plan, under which all ICRM support is targeted to residential lines based on a showing that the total revenue opportunity for serving a residential line is less than that for serving a business line.

The second, the "Transitional Network Recovery Mechanism," or "TNRM," is available to CRTCs. Its availability to CETCs competing with these carriers is limited to those (including new entrants) that lose access revenues as a result of the plan. Because CMRS carriers do not receive switched access charges, this transitional restriction is intended to allow only wireline CETCs to receive support from the TNRM, on a per-eligible line basis. The Plan calls for the FCC to review whether additional CETCs should receive support from the TNRM at the conclusion of the initial term of the Plan, in 2013. TNRM may be disaggregated in accordance with the Commission's existing rules governing disaggregation of support for rural carriers.

In addition, the Plan also makes several improvements to existing support mechanisms, including the rural high cost loop support mechanism (removing the cap, unfreezing the national average unseparated cost per working loop, and eliminating the rule reducing support for carriers serving over 200,000 lines) and the safety valve support mechanism (providing augmented support in the partial year and first full year after an acquisition closes, and creating "Safety Valve II," to provide analogous support for switching and transport investment). In addition, the Plan provides an option for certain price cap CRTCs to elect to receive support under the non-rural, model-based high cost mechanism. Finally, the Plan provides that the existing per-line universal service support amount will remain portable to competitive eligible telecommunications carriers.

To fund all existing and new mechanisms, the Plan creates a new uniform universal service contribution methodology based on "units" applied to telephone numbers and high-capacity network connections. Under this methodology, each unique working telephone number is assessed one unit, and the Plan allows CMRS carriers, CRTCs, and CRTC competitors to phase this assessment in for additional numbers in a residential household account. Residential DSL, cable modem, and other high-speed, non-circuit-switched connections are also assessed one unit, harmonizing today's disparate treatment of DSL and cable modem services. For business connections, the Plan establishes a four-tiered system of assessments for non-switched, dedicated network connections ranging from one to 100 units depending on capacity.

IV. The Benefits of the ICF Plan

By creating uniform national default network interconnection, intercarrier compensation, and universal service rules, the ICF Plan will benefit both consumers and the U.S. economy. Consumers will have access to more services and greater competition once the "rules of the road" are rationalized. They will be more readily able to purchase innovative products and service they want, in affordable bundles. The Plan will better enable carriers to offer flat-rated, all-distance plans that CMRS customers have embraced, and will promote economically rational pricing and efficient competition, sending correct pricing signals to consumers.

Rural and low-income consumers in particular will benefit, as the Plan will promotes greater choice and less restrictive calling options, including expanded local calling scopes, and greater choice in broadband and long distance services. The Plan will further promote universal service by promoting comparability of urban and rural services and prices, replacing support that is implicit in intercarrier compensation today with explicit support provided by transparent, sustainable mechanisms. Moreover, the Plan protects low-income consumers by exempting Lifeline customers from SLC rate increases and universal service contribution pass-throughs.

The U.S. economy also will benefit from the ICF Plan. By increasing certainty in the telecommunications industry, the Plan will facilitate carrier business planning and access to capital markets. In addition, by reducing areas of dispute, the Plan will allow carriers to lower their costs and devote greater resources to developing and launching new and innovative products and services. The Plan will also minimize arbitrage opportunities and competitive distortions by eliminating artificial, uneconomic distinctions among functionally equivalent services.

Finally, implementation of the Plan will harmonize compensation for circuit-switched services with that applicable to wireless and VOIP services.

V. Conclusion

The ICF will shortly be filing a substantial narrative containing the detailed ICF Plan, which must take effect by July 1, 2005. The ICF urges the Commission expeditiously to seek comment on that Plan and to adopt rules implementing it in advance of that date.

TAB B

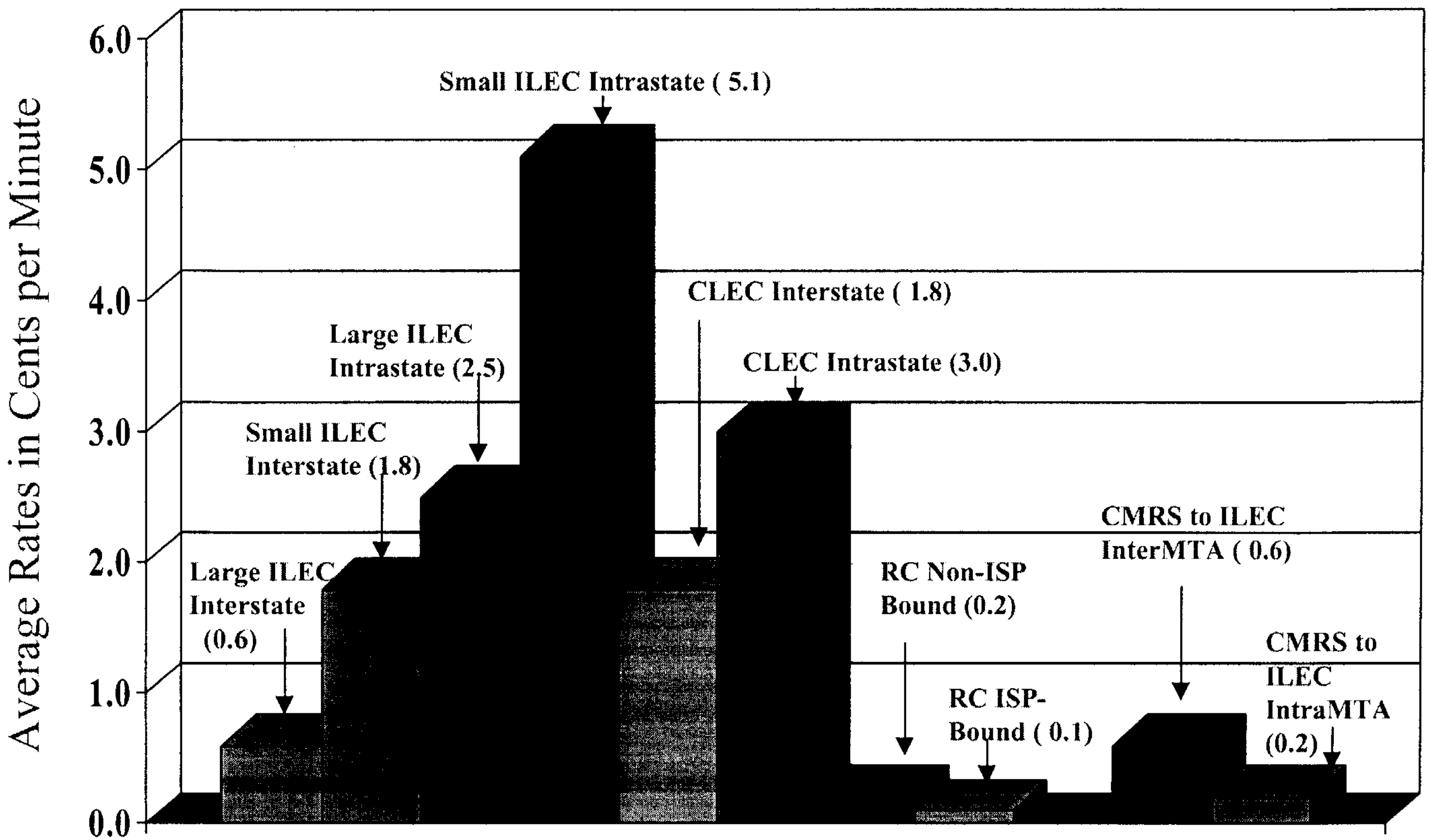
Intercarrier Compensation Forum

Intercarrier Compensation and Universal Service Reform Plan

August 13, 2004

LATHAM & WATKINS LLP

Intercarrier Compensation Rates



High (¢/min):	1.5	8.9	9.9	34.9	6.8	35.9	0.3	0.1	8.9	0.3
Low (¢/min):	0.5	0.3	0.4	0.7	0.2	0.4	0.0	0.0	0.2	0.0

LATHAM&WATKINS LLP

Today's Broken System Harms the Economy

- Disparities create artificial regulatory advantages and disadvantages among telecommunications carriers, leading to arbitrage and uneconomic substitution.
- Intercarrier compensation disputes create tremendous recordkeeping, auditing, and dispute resolution costs.
- These disputes limit carrier ability to formulate business plans by creating uncertainty that impedes access to capital markets.
- Disparate intercarrier compensation schemes cause network inefficiencies.

Today's Rules Harm Consumers

- Consumers do not receive the service packages they want:
  - Legacy retail pricing plans and underlying intercarrier compensation regimes limit calling scope size.
  - Carriers must distinguish between "local" and "long-distance" services.
- Consumers pay inflated, averaged toll rates that include implicit universal service support.
- Low income consumers in particular are at risk of losing service if they cannot afford the resulting high toll bills.
- Rural consumers face high toll bills, small local calling areas, and limited long distance and broadband choices.

TAB C

KELLEY DRYE & WARREN LLP
A LIMITED LIABILITY PARTNERSHIP

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October 1, 2004

Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic, CC Docket Nos. 96-98 and 99-68

Dear Ms. Dortch:

In recent weeks, the Commission has received a flurry of *ex parte* submissions, including this and other *ex partes* submitted on behalf of KMC Telecom, Inc. ("KMC"), XO Communications, Inc. ("XO") and Xspedius Communications, LLC ("Xspedius"), on how it should resolve issues related to reciprocal compensation for ISP-bound traffic now on remand for the second time from the D.C. Circuit. A decision regarding these matters is long over due.

ISP-Bound Traffic Is Subject to Reciprocal Compensation under Section 251(b)(5)

The Commission's removal of legally flawed rules that benefit solely incumbent LECs at the expense of competitive LECs, their ISP customers and the multitude of consumers who use "dial-up" to reach their ISP of choice is not only the correct legal outcome, it is, for numerous reasons, the correct policy outcome. The weight of the *ex partes*, as well as the D.C. Circuit's opinions, point toward a clear result: ISP-bound traffic is subject to reciprocal compensation under section 251(b)(5). A decision holding that ISP-bound traffic is subject to reciprocal compensation under section 251(b)(5) is the only legally sustainable outcome. After years of regulatory uncertainty, legal sustainability should be a paramount goal.

As some have noted, such an outcome actually serves the Commission's goal of rationalizing diverse forms of intercarrier compensation. As the Commission correctly found in the *ISP Remand Order*, section 251(b)(5) does not turn on whether traffic is local.[1] It should not now be goaded into thinking that it turns on whether traffic is interstate.[2] Section 251(b)(5) applies to *all telecommunications traffic*. Any theory that puts some of that traffic exclusively within the FCC's realm is sure to put something else without.

As the Supreme Court already has recognized, under sections 251(b)(5) and 252(d)(2), the FCC has ample room to adopt guidelines that can form and, in large measure, control the resolution of reciprocal compensation issues.[3] The one thing it seems that it cannot do is to actually set rates.[4] Each argument filed to date that says the FCC can simply usurp the state commissions' role under section 252 – whether on a section 251(i) or on a section 201 theory, or some combination thereof – ignores the section 251(g) debacle that was laid to rest by the *WorldCom* court and fails to provide a rational legal basis for replacing the words "State commission" that appear in section 252(d)(2) with "FCC".

In any event, if there is a theory under which the FCC can set rates for traffic subject to reciprocal compensation under section 251(b)(5), it would certainly be a novel one and it might not rest on the Commission's legacy jurisdiction under section 201. The Commission should explore such theories and seek the industry's input on them. There is no compelling need to adopt a vulnerable theory now that may get overturned or that may get upheld and then tie the Commission's hands later. For now, there is an obvious and legally sustainable solution: section 252(d)(2) rates for ISP-bound traffic. The Commission can set such a rule while reserving all rights to explore the impact of its jurisdiction under 201, and 251/252, for that matter.[5]

Thus, even if there is a legally sustainable argument whereby the FCC actually can set a compensation rate for a subset of (or all) section 251(b)(5) traffic, the FCC should only

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1 *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98 and 99-68, FCC 01-131, Order on Remand and Report and Order, 16 FCC Rcd 9151, ¶¶ 45-46 (rel. Apr. 27, 2001), *remanded without vacatur, WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002) ("*ISP Remand Order*").

2 *See Ex Parte* Brief of BellSouth Corporation and Verizon in CC Docket Nos. 96-98 and 99-68 ("Internet Bound Traffic is not Compensable Under Sections 251(b)(5) and 252(d)(2)"), filed May 17, 2004; Supplemental White Paper of BellSouth Corporation and Verizon on ISP Reciprocal Compensation in CC Docket Nos. 96-98 and 99-68, filed July 20, 2004.

3 *See AT&T Corp. v. Iowa Util. Bd.*, 525 U.S. 366, 384-85 (1999).

4 Per section 332, the Eighth Circuit found CMRS traffic to be an exception to this rule. There is no section 332 analogue for ISP-bound traffic.

5 Notably, the Commission's determinations regarding intercarrier compensation for CMRS traffic have not diminished its section 332 jurisdiction.

avail itself of that option in the context of broader intercarrier compensation reform. Perpetuation of non-cost based rates (non-251(b)(5)/252(d)(2) rates) for some section 251(b)(5) traffic only creates another rate level and another opportunity for arbitrage.[6] If rationalization is to involve a single rate for all traffic within the FCC's reach, a rational first step would be to require the same cost-based rate for all section 251(b)(5) traffic.

Growth Caps and the New Market Bar Must Be Eliminated (Regardless of the Statutory Theory that May or May Not Be Used to Resolve the Rate Issue)

The existing regime of non-252(d)(2) compliant rates, growth cap and new market bars results in an unearned windfall for the incumbent LECs and, most perniciously, it protects them and their affiliates from new and intensified competition in the ISP market. There simply is no compelling or rational basis for not eliminating the growth cap and new market rules immediately. These rules affirmatively dis-serve a purpose by hobbling competitive LECs' ability to expand their offerings to new customers and new markets. Protecting incumbent LECs in this manner and denying consumers of alternative means of connectivity to the Internet is bad for the economy and bad for consumers. Notably, the consumers hardest hit by the existing regime are those who choose dial-up because they cannot afford broadband, cannot get broadband, or simply have not developed the demand for broadband (although they might – and that should be encouraged). The growth cap and new market rules act as a booted foot on the neck of competitive LECs, ISPs and consumers; the Commission must provide relief by eliminating them.

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6 Yes, incumbent LEC avoidance of cost-based reciprocal compensation obligations is arbitrage. If the penny-a-minute rates that prevailed in late 1990s were too high, it is because the incumbents themselves set them or had too strong a hand in setting them. Today's state commission-approved and section 252(d)(2) compliant rates are much lower. Certain states have even adopted new rate structures that further drive down the rates associated with calls, such as ISP-bound calls, that typically have long holding times. And, there is seldom heard a claim from the incumbent LECs that these TELRIC-based rates for switching functionality are *too low*, as they are seemingly pre-programmed to complain about other TELRIC-based rates. On the other-hand, the prevailing FCC-set rate of $0.0007 is generally much lower than the TELRIC-based reciprocal compensation rates which the ILECs had every incentive to drive down. The FCC-set rate, is by definition, below cost. Whether above or below cost, somebody gains and somebody loses. In the case of ISP-bound traffic, the FCC-set below cost rate results in the FCC picking the incumbent LECs as the winner of an undeserved subsidy from their much smaller competitors. With the uniform application of cost-based rates – carriers simply pay for what they get – and there are no winners and losers arbitrarily chosen.

ISP-Bound Traffic Is Not Subject to Intrastate Access Charges

Competitive LECs often provide ISPs with virtual-NXX services that enable ISPs to serve consumers more efficiently and cost effectively. Often, it is these arrangements that make it possible to cost-effectively serve a greater number of geographic areas and consumers that may live in less populated suburban and rural areas. Contrary to CenturyTel's claims, these vNXX arrangements impose no additional transport obligations on the incumbent LECs – they bring traffic to the same point of interconnection regardless of whether a vNXX arrangement is used.[7] They also do not cause or contribute to toll blockage, as the calls are delivered over local interconnection trunks.[8] What does happen, however, is that the incumbent LEC is no longer able to force a consumer to make a toll call. Allowing consumers not to be forced into placing toll calls to access the Internet via non-incumbent LEC-controlled ISPs is not at all bad policy. In fact, it is affirmatively good policy. Moreover, it is the legally correct outcome for a number of reasons. First, ISP-bound calls have never been subject to access charges, regardless of where servers or billing addresses are located. These calls are subject to section 251(b)(5) and 252(d)(2) which effectively bars application of originating and terminating access charges.[9] Second, ISP-bound calls are neither exchange access nor toll, by definition.[10] And, finally, since ISP-bound traffic is jurisdictionally interstate, intrastate access charges cannot apply. At bottom, one thing is indisputable: intrastate access charges cannot apply to ISP-bound traffic, regardless of delivery method. In order to correct the detrimental effect on consumers, competitors and the growth of the Internet as an increasingly critical part of the national economy, the Commission must at this juncture affirmatively pre-empt any state commission decisions that apply intrastate access charges to ISP-bound traffic or that either fail to comport with the requirements of section 252(d)(2) or that differ from any FCC-set rate.[11]

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7 *Ex Parte* Letter from Tonya Rutherford, Esq., CenturyTel, Inc. to Marlene H. Dortch, Secretary, Federal Communications Commission in CC Docket Nos. 96-98, 99-68 and 01-92 (Sept. 24, 2004) at 1.

8 *See id.*

9 *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98 and 95-185, FCC 96-325, First Report and Order, 11 FCC Rcd 15499, ¶ 1033 (rel. Aug. 8, 1996) ("*Local Competition Order*").

10 Under section 3(16), "exchange access" means the offering of access to telephone exchange services or facilities for the purpose of origination or termination of telephone toll services. Under section 3(48), "telephone toll service" means telephone service between stations in different exchange areas for which there is made a separate charge not included in the contracts with subscribers for exchange service.

11 Again, KMC, XO and Xspedius do not at this time recognize a legal basis upon which the FCC could set compensation rates for section 251(b)(5) traffic. However, if the FCC were to take that course, it should most certainly preempt state commission decisions that apply different rates (including bill-and-keep/zero rate) and rate structures (intrastate access charges).

A Holding that ISP-Bound Traffic Is Once Again Not Subject to Section 251(b)(5) and Is Instead Subject to a Different Intercarrier Compensation Scheme under Section 201 Is Not Legally Sustainable

In the face of two harsh defeats at the D.C. Circuit and strong indication from that Court that ISP-bound traffic is indeed subject to section 251(b)(5), some still argue that there is an exception or loophole intended by Congress that would alleviate them from having to pay cost-based reciprocal compensation to other carriers for the delivery of calls to ISPs. The twin sisters advocating this theory, Verizon and BellSouth, simply ignore the Commission's own definition of "termination"[12] and the D.C. Circuit's guidance on it in the *Bell Atlantic* decision. Although drawn-up in impressive length, the Verizon/BellSouth argument rests upon nothing more than fiction and word-play.[13] The fact of the matter is that when calls are made to ISPs, the LEC serving the ISP performs a termination function when it delivers the call to the ISP. Thus, Verizon and BellSouth's attempt to throw ISP-bound traffic into a void created by a false exception to section 251(b)(5) must be rejected. The statute and the FCC's definition point toward a functionality called "termination" and prescribes that carriers be compensated for performing it. To say that an ISP-bound call does not "terminate" when a CLEC delivers a call to an ISP is tantamount to saying that a flight that connects through a hub in Atlanta does not land there. Not only is there no legal merit to the argument (indeed, the D.C. Circuit saw no legal merit in the argument when rejecting it in the *Bell Atlantic* decision[14]), it defies common sense. Moreover, the fact that termination occurs at intermediate points of a communication – which fairly can be called intermediate termination points – does not impact the Commission's assertion of section 201 jurisdiction based on the ultimate end-points, or final termination point (which, incidentally, is likely to be multiple points, many actually local and not across the states and the globe).

SBC, while good enough to expose the "does not terminate"/non-section 251(b)(5) charade presented by its siblings, does not put forth a more coherent theory. Although difficult to discern or make any sense of, SBC appears to present a hybrid of arguments rejected in the *Bell Atlantic* and *WorldCom* decisions. According to SBC, the Commission's 1983 decision not to include ESPs in the interstate access charge scheme somehow makes ISP-bound traffic subject to section 251(g), as well as section 251(b)(5) – and, as a result, the Commission

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12 47 C.F.R. § 51.701(d). Under the Commission's current rules, "termination" is the switching of telecommunications traffic at the terminating carrier's end office switch, or equivalent facility, and delivery of such traffic to the called party's premises.

13 *See supra* n.2.

14 *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1, 9 (D.C. Cir. 2000).

gets to use section 251(i) to invoke section 201 powers to modify the regime preserved under section 251(g) so as to add the additional (but not grandfathered) requirement of bill-and-keep for calls exchanged between LECs that then get delivered to ISPs, and to nullify section 252(d)(2) in the process. This wild ride is perhaps the most tortured of all statutory interpretations yet presented on the topic. But, it falls flat, as there simply were no pre-Act obligations relating to intercarrier compensation for ISP-bound traffic enshrined in the so-called ESP exemption, or elsewhere,[15] that are preserved under section 251(g) or that could be modified via section 251(i) to arrive at a result other than section 251(b)(5) reciprocal compensation at section 252(d)(2) rates.

The so-called ESP exemption did not contemplate competitive LECs or the fact that a LEC serving an ISP would be required to incur the additional costs associated with the termination of locally dialed calls to ISPs from customers who were not their own.[16] Further, ISPs are not IXCs. They do not use "exchange access", as it is defined in the statute, and they are not telecommunications services providers. In *Bell Atlantic*, the D.C. Circuit already indicated its view that the so-called ESP exemption did not at all suggest that ISP-bound traffic was outside the scope of section 251(b)(5).[17] If anything, the court's opinion suggests that ISP-bound traffic is within the scope of section 251(b)(5). In *WorldCom*, the Court found that there was no intercarrier compensation scheme for ISP-bound traffic that could be preserved under section 251(g).[18] Thus, it is inconceivable (as opposed to indisputable, as SBC suggests) that the so-called ESP exemption creates an access charge regime that pulls ISP-bound traffic at least partially or temporarily outside the scope of sections 251(b)(5) and 252(d)(2) and into a realm where sections 251(g), 251(i) and 201 collide to result in bill-and-keep/zero-rated reciprocal compensation for ISP-bound traffic.[19]

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15 Under SBC's theory, the "ESP exemption" becomes the "ESP access charge regime", which is somehow preserved under section 251(g).

16 SBC's assertion that there are no additional costs caused when one carrier sends a call to another that requires transport and termination is factually incorrect. *ISP Remand Order*, ¶¶ 91-92.

17 *Bell Atlantic*, 206 F. 3d at 335.

18 *See WorldCom*, 288 F.3d at 433.

19 Given SBC's failure to compete effectively for ISP customers, bill-and-keep for ISP-bound traffic would be a sizable regulatory windfall to SBC accomplished via an unconstitutional taking from carriers who serve ISPs that chose not to buy service from SBC. Like SBC, Qwest suggests bill-and-keep without providing a legally sustainable explanation as to how it could be imposed for out-of-balance traffic. *See* SBC Sept. 13, 2004 *Ex Parte* at 5, Qwest May 21, 2004 *Ex Parte* at 3. Contrary to Qwest's suggestion, a "robust" interpretation of section 252(d)(2)(B)(i) does not appear to permit the Commission to do anything. Under Section 252(d)(2), state commissions set or approve reciprocal compensation rates. And section 252(d)(2)(B)(i) does not permit the states to adopt bill-and-keep for out of balance traffic either, as that

A "Pure" Section 201 Theory Raises Vexing Problems and Threatens Consumers' Access to the Internet

A "pure" section 201 resolution of the matter presents a host of other vexing problems – in addition to those caused by a lack of legal sustainability and the needless regulatory uncertainty that would ensue from such a false resolution. Chief among these problems are issues created by, as the incumbent LECs will argue, taking such traffic outside the scope of section 251. Today, ISP-bound traffic is exchanged via local interconnection trunks and pursuant to state commission approved interconnection agreements. It is foreseeable that the incumbent LECs will push to move such traffic off of TELRIC-priced section 251(c)(2) interconnection facilities and onto over-priced special access facilities. Higher costs have consequences. The consequences here would result in higher rates for dial-up internet access, which is the only option in some areas and for some who simply cannot afford or do not have the need for broadband – even if they could get it. The detrimental impact of a non-251(b)(5) decision would certainly hit less densely populated areas and less economically privileged consumers hardest.

Enforceability, although never easy under a section 251 construct, would become an evermore vexatious problem in a section 201 scheme. When the incumbents again refuse to pay, what will be enforced and who would enforce it? Would any competitors be able to withstand the process or will the choices for ISPs dry-up? The Commission needs to remember that non-affiliated ISPs have predominantly switched to competitive LECs for better service at better prices. What good could come from forcing them back on to the incumbent LECs' networks?

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would conflict with the cost recovery scheme set forth in sections 251 and 252 that establishes LEC-to-LEC traffic exchange obligations and may otherwise result in an unconstitutional taking. *See* U.S. Const. art. V.

A "Pure" Section 201 Theory Does Not Add to the FCC's Jurisdiction and Section 251(b)(5) Compensation Does Not Diminish It

Few carriers challenge the Commission's determination that ISP-bound traffic is jurisdictionally interstate. Yet, it has been suggested that a "pure" section 201 resolution to these issues is necessary to preserve the FCC's claimed jurisdiction over the Internet. It is difficult to see why that is necessary (or how a non-251(b)(5) solution could be legally defensible). The Commission would not cede its section 201 jurisdiction by properly finding that ISP-bound traffic is subject to section 251(b)(5) reciprocal compensation. Section 251(i) makes that clear. Moreover, the Commission does not waive jurisdiction by allowing states to set compensation rates – subject to FCC guidelines – under section 252(d)(2). The Commission also cannot lawfully add to its jurisdictional mandate – only Congress can do that. And so, for comfort, the Commission can affirmatively reserve all rights to explore the scope of its jurisdiction under section 201. That should do more than is needed to preserve the Commission's jurisdiction over the Internet.

In accordance with section 1.1206 of the Commission's rules, 47 C.F.R. § 1.1206, a copy of this letter has been filed in the above-referenced proceeding. Please feel free to contact me at (202) 955-9888 if you have any questions.

Respectfully submitted,

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